

PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

ENERGY DIVISION

RESOLUTION E-3981

May 25, 2006

R E S O L U T I O N

Resolution E-3981. Southern California Edison (SCE) requests confirmation that costs incurred by SCE pursuant to a standstill agreement entered into with Peabody Western Coal Company (Peabody) and the Black Mesa Pipeline Company are fuel-related costs that can be recorded directly into the Energy Resource Recovery Account (ERRA) balancing account.

By Advice Letter 1952-E Filed on December 29, 2005.

SUMMARY

SCE may record \$5.013 million in standstill agreement costs to the ERRA balancing account.

This Resolution confirms Energy Division's concurrence with Southern California Edison (SCE) that recording the cost of its standstill agreement with Peabody to the ERRA balancing account is appropriate.

This Resolution does not authorize SCE to record the cost of its standstill agreement with Black Mesa Pipeline, Inc. (BMPI) to the ERRA balancing account, at this time.

SCE should be prepared to demonstrate that it exercised reasonable due diligence and negotiated in good faith to modify the pollution control requirements in order to recover standstill agreement costs recorded into the ERRA, in rates.

BACKGROUND

SCE was in discussion to maintain its coal fuel supply while efforts were made to reopen Mohave.

On December 31, 2005, Mohave Generating Station (Mohave) a two-unit, coal fired power plant located in Laughlin, Nevada, shut down operations. As of the end of 2005, BMPI ceased shipping coal, via the Black Mesa Pipeline, from the Peabody's Black Mesa mine to Mohave. Mohave's coal supply contract with Peabody also expired at the end of 2005.

SCE was trying to preserve the option for continued coal operations at Mohave prior to installation of pollution control equipment. In conjunction with that effort, SCE was in discussions with Peabody and BMPI for temporary agreements in which Peabody would maintain the Black Mesa Mine and BMPI would maintain the Black Mesa Pipeline in sufficient readiness so as to permit a timely return to production if SCE's effort for continued coal operations prior to installation of pollution controls was successful.

SCE plans to record standstill agreement costs directly to the ERRA balancing account.

SCE believes that recording the standstill agreement costs directly to the ERRA balancing account is appropriate since this ratemaking treatment is consistent with SCE's currently effective Commission-approved ERRA tariff which authorizes Utility Retained Generation (URG) Fuel and Fuel-related Expenses to be recorded in the ERRA balancing account as they are incurred.

SCE's URG Fuel and Fuel-related Expenses are defined in SCE's ERRA tariff as: (1) variable fuel expenses (commodity and fuel transportation), (2) fixed (unavoidable) fuel expenses, (3) fuel inventory carrying charges, (4) fuel contract settlement, buy-out, and renegotiation costs, and (5) other costs as approved by the Commission.

The standstill arrangements are similar to the activities contemplated in the ERRA forecast proceeding.

SCE believes that these activities are analogous to the activities contemplated in SCE's 2006 ERRA forecast of operations proceeding (A.05-08-002). While that forecast assumed that Mohave would be temporarily shut down during 2006, SCE identified costs necessary to maintain or preserve the Black Mesa Mine coal supply. No party opposed SCE's ERRA proceeding revenue requirement. The standstill arrangements are similar to the activities contemplated in the ERRA forecast.

Standstill agreement costs will be subject to reasonableness review.

Like any other fuel-related costs recorded in the ERRA balancing account, SCE's actual fuel-related standstill agreement costs will be subject to full review by the Commission and other interested parties in SCE's annual ERRA reasonableness of operations proceeding.

SCE seeks confirmation that Energy Division concurs in its treatment of the standstill agreement costs.

SCE filed AL 1952-E to clarify that costs that SCE incurred under its standstill agreements are fuel-related costs that can be recorded directly to the ERRA balancing account.

NOTICE

Notice of AL 1952-E was made by publication in the Commission's Daily Calendar. SCE states that a copy of the Advice Letter was mailed and distributed in accordance with Section III-G of General Order 96-A.

PROTESTS

Advice Letter AL 1952-E was protested.

SCE's Advice Letter AL 1952-E was timely protested by The Natural Resources Defense Council (NRDC) on January 18, 2006.

NRDC protests that SCE did not recognize, and request funding for, generation alternatives to Mohave

NRDC filed protests to AL 1952-E, and AL 1953-E (also related to Mohave) in the same letter. NRDC protests that SCE's advice letters do not recognize generation alternatives to Mohave and that SCE should request funds to pursue development of the alternatives to be identified in a forthcoming final study. NRDC also suggests that the CPUC should be mindful of the long-term effects associated with greenhouse gas emissions that are associated with a return to operation of Mohave.

SCE responded to NRDC's protest on January 25, 2006.

SCE's response to NRDC's protest is discussed in Resolution E-3977 for AL 1953-E.

NRDC's protest does not relate to SCE recording standstill agreement costs to the ERRA balancing account, the subject of AL 1952-E, and this Resolution. NRDC's protest concern general issues surrounding continued Mohave operations. SCE's response to NRDC's protest was addressed in Resolution E-3977 for AL 1953-E.

DISCUSSION

Energy Division agrees that recording standstill agreement costs to the ERRA balancing account, while SCE attempted to reopen Mohave, is appropriate. SCE may record standstill agreement cost with Peabody of \$5,013,361 in the ERRA.

SCE's request to include costs related to the BMPI standstill agreement is denied without prejudice. SCE may file a separate advice letter to seek authority to record the BMPI standstill agreement costs of \$809,187 to the ERRA.

ERRA balancing account records URG fuel and fuel-related expenses.

Decision 02-10-062 established the ERRA balancing account. The purpose of the ERRA is, among other things, to record SCE's URG fuel costs. URG includes all of SCE's generating facilities, including its ownership share of Mohave. SCE's URG fuel and fuel-related expenses include:

- Variable fuel expenses (commodity and fuel transportation);
- Fixed (unavoidable) fuel expenses;
- Fuel inventory carry charges;
- Fuel contract settlement, buyout, and renegotiation costs;
- And other costs as approved by the Commission.

The standstill agreement cost is fuel-related.

On December 31, 2005, SCE shut down operations at Mohave due to emission control requirements. SCE's coal fuel contract with Peabody and coal delivery contract with BMPI also terminated on that date. While attempting to resume operations at Mohave prior to installation of pollution control equipments, SCE entered into a standstill agreement with Peabody to preserve its coal fuel supply

and with BMPI to preserve its ability for future coal deliveries. The standstill agreements were not extended beyond their termination dates of March 31, 2006.

The standstill agreement costs are fuel-related. As such, they could be recorded in the ERRA balancing account.

While Energy Division agrees that standstill agreement costs can be recorded in the ERRA balancing account, Energy Division has concerns with the BMPI standstill agreement.

The BMPI standstill agreement is memorialized in a three-page letter agreement dated March 27, 2006, covering the period of January 1, 2006 to March 31, 2006. In effect, the letter agreement with BMPI was signed just four days prior to its termination. In its late comment, SCE states that the letter agreement of March 27, 2006 reflected an agreement among the parties of January 23, 2006. SCE provided an email dated February 9, 2006 and a draft of the agreement letter to demonstrate that SCE was in negotiations with BMPI.

In addition to the irregular timing of the BMPI standstill agreement, the Mohave Monthly Status Report of March 29, 2006 fails to mention the status of BMPI's standstill agreement. That same report, however, does identify Peabody's standstill agreement as not being extended beyond its current termination date.

The invoicing practice of the BMPI standstill agreement also raises questions. While the BMPI standstill agreement states that BMPI will invoice SCE on a monthly basis, the first invoice from BMPI was received by SCE on April 26, 2006 and a revised invoice on May 5, 2006. While SCE states that it was understood by BMPI that SCE would not remit payment until after the standstill agreement was finalized, it is irregular that a vendor would not invoice until nearly three months after services were provided.

These are significant irregularities that raises concern. SCE should not record the BMPI standstill agreement costs in the ERRA balancing account at this time. SCE should file a separate advice letter to seek Energy Division authorization to include BMPI standstill agreement costs in the ERRA. In its advice letter filing, SCE should include sufficient documentation to support a conclusion that a genuine liability had been incurred.

The directive today to exclude the BMPI standstill agreement costs from being recorded to the ERRA should not prejudice SCE's future advice letter filing.

SCE may record \$5.013 million in standstill agreement costs with Peabody to the ERRA balancing account.

Resumption of operation at Mohave is uncertain. In its March 29, 2006 monthly Mohave status report, SCE concluded that further aggressive pursuit of interim operations at this time was not warranted, and SCE's current estimate was that Mohave will not resume operating before approximately 2010.

The monthly status report also noted that the standstill agreement which was entered into in late December 2005 with Peabody has not been extended beyond its termination date of March 31, 2006.

As such, SCE may record in the ERRA balancing account, \$5,013,361 which represents SCE's 56% share of standstill agreement costs (including royalties and taxes) entered into with Peabody as of December 29, 2005.

Recovery of standstill agreement costs is subject to Commission review in SCE's annual ERRA reasonableness of operations proceeding.

Standstill agreement costs recorded in the ERRA will be subject to a reasonableness review before SCE can recover the recorded costs. SCE should request recovery in its annual ERRA reasonableness of operations proceeding.

SCE must demonstrate that the standstill agreement costs were reasonably incurred.

In its application to justify recovery in rates of standstill agreement costs, SCE should be prepared to demonstrate that, while the standstill agreement was in effect, SCE exercised reasonable due diligence and negotiated in good faith to modify the pollution control requirements such that Mohave could resume operating on an interim basis, prior to installation of the pollution controls. SCE's demonstrations should include, at a minimum, renegotiation meeting agendas, minutes, and change in term proposals.

NRDC's protest is not related to standstill agreement costs.

NRDC filed its protest to AL 1952-E and AL 1953-E in the same letter. NRDC's protest does not address the specific question of whether the standstill agreement costs should be recorded to the ERRRA balancing account. As noted in Resolution E-3977-E to AL 1953-E, NRDC's concerns and comments may be better addressed in future Mohave proceedings that are broader in scope. NRDC's protest is denied.

COMMENTS

Public Utilities Code section 311(g)(1) provides that this resolution must be served on all parties and subject to at least 30 days public review and comment prior to a vote of the Commission.

The 30-day comment period for the draft of this resolution was neither waived nor reduced. Accordingly, this draft resolution was mailed to parties for comments. This draft resolution will be placed on the Commission's agenda for the May 25, 2006 meeting.

SCE filed late comments on May 10, 2006. Comments were originally due April 28, 2006. SCE filed late comments because SCE inadvertently failed to inform the Energy Division of a similar standstill agreement that SCE entered into with the operator of the Black Mesa to Mohave coal slurry pipeline, Black Mesa Pipeline, Inc. (BMPI).

SCE requested in its late comment that the revised draft resolution be modified to expressly recognize the standstill agreement between SCE and BMPI. SCE stated that the BMPI standstill agreement was formally documented and memorialized in a letter agreement of March 27, 2006, reflecting an agreement among the parties of January 23, 2006. SCE also requests that the total standstill agreement cap identified in the revised draft resolution be increased from \$5.013 million to \$5.823 million, which represents SCE's 56% share of standstill costs.

Energy Division provided parties on the service list an opportunity to provide reply comments to SCE's late comments. No reply comments were filed.

The revised draft resolution has been modified to incorporate SCE's late comment and is reflected throughout herein.

FINDINGS

1. D.02-10-062 established the Energy Resource Recovery Account (ERRA) balancing account.
2. The purpose of the ERRA is, among other things, to record SCE's Utility Retained Generation (URG) fuel costs.
3. URG includes all of SCE's generating facilities, including its ownership share of Mohave.
4. SCE URG fuel and fuel-related expenses include:
 - Variable fuel expenses (commodity and fuel transportation);
 - Fixed (unavoidable) fuel expenses;
 - Fuel inventory carry charges;
 - Fuel contract settlement, buyout, and renegotiation costs;
 - And other costs as approved by the Commission.
5. SCE shut down operations at Mohave on December 31, 2005.
6. SCE's coal fuel supply contract with Peabody Western Coal Company (Peabody) terminated on December 31, 2005.
7. SCE entered into a standstill agreement with Peabody to preserve its coal fuel supply while attempting to resume operations at Mohave on an interim basis, prior to installation of pollution controls.
8. SCE filed AL 1952-E on December 29, 2005 requesting authorization to record standstill agreement costs in the ERRA balancing account.
9. The Natural Resources Defense Council (NRDC) timely protested SCE's Advice Letter 1952-E on January 18, 2006.
10. SCE responded to NRDC on January 25, 2006.
11. SCE filed late comments on May 10, 2006.
12. SCE's late comments sought to include a standstill agreement with Black Mesa Pipeline, Inc. (BMPI) that was not included in the original advice letter filing.
13. SCE's 56% share of BMPI standstill cost totaled \$809,187.23.
14. No reply comments to the late comments were received.
15. The standstill agreements are fuel-related.
16. Energy Division concurs that as a general matter it is appropriate to record standstill agreement costs in the ERRA balancing account.
17. Energy Division has concerns with SCE's standstill agreement with BMPI.
18. Resumption of operation at Mohave is uncertain.
19. In its March 29, 2006 monthly Mohave status report, SCE reported that further aggressive pursuit of interim operations at this time was not

- warranted, and that SCE's current estimate was that Mohave will not resume operating before approximately 2010.
20. SCE also reported that the standstill agreement with Peabody has not been extended beyond its current termination date of March 31, 2006.
 21. SCE's 56% share of standstill agreement cost (including royalties and taxes) with Peabody is \$5,013,361.03.
 22. NRDC's protest does not relate to SCE recording standstill agreement costs to the ERRA balancing account, the subject of AL 1952-E, and this Resolution. NRDC's protest concern general issues surrounding continued Mohave operations.

THEREFORE IT IS ORDERED THAT:

1. The request of the Southern California Edison (SCE) for confirmation that the Energy Division concurs with SCE's recordation of standstill costs to the Energy Resource Recovery Account (ERRA) as requested in Advice Letter AL 1952-E is approved, as modified in Ordering Paragraph 3, 4, 5, 6, 7 and 8.
2. Energy Division concurs with recording standstill agreement costs to the ERRA balancing account, subject to cost limitation.
3. SCE may record in the ERRA balancing account, SCE's 56% share of standstill agreement cost (including royalties and taxes) of \$5,013,361.03 entered into with Peabody as of December 29, 2005.
4. SCE may not record costs of the standstill agreement entered into with BMPI dated March 27, 2006, at this time.
5. SCE's request to include costs related to the BMPI standstill agreement is denied without prejudice.
6. SCE may file a separate advice letter to seek Energy Division authorization to include BMPI's standstill agreement cost of \$809,187.23 in the ERRA balancing account.
7. Recovery of standstill agreement cost is subject to Commission review in SCE's annual ERRA reasonableness of operations proceeding.
8. To recover standstill agreement costs in rates, SCE must demonstrate that, while the standstill agreement was in effect, SCE exercised reasonable due diligence and negotiated in good faith to modify the pollution control requirements.
9. The Natural Resources Defense Council's protest is denied.

This Resolution is effective today.

I certify that the foregoing resolution was duly introduced, passed and adopted at a conference of the Public Utilities Commission of the State of California held on May 25, 2006; the following Commissioners voting favorably thereon:

STEVE LARSON
Executive Director

MICHAEL R. PEEVEY
PRESIDENT
GEOFFREY F. BROWN
DIAN M. GRUENEICH
JOHN A. BOHN
RACHELLE B. CHONG
Commissioners